No. 14,549

United States Court of Appeals

For the Ninth Circuit

SPENCER GRANT, Executor of the Last Will and Testament of BLANCHE KELLEHER GRANT, Deceased,
Appellant and Appellee,

vs.

JAMES G. SMYTH, Former Collector of Internal Revenue,
Appellee and Appellant.

On Appeals from the Judgment of the United States District Court for the Northern District of California.

BRIEF FOR THE COLLECTOR.

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BRIEF FOR THE COLLECTOR.

OPINION BELOW.

The only previous opinion in the present case is that of the District Court (R. 37-48), which is reported in 123 F. Supp. 771.

JURISDICTION.

These cross-appeals involve federal estate taxes of Blanche Kelleher Grant, who died on March 2, 1947.

(R. 37-38.) The taxes in dispute, in the amount of $29,235.79, together with interest in the amount of $161.89, were paid by the executor on September 22, 1950. (R. 35, 38.) An amended claim for refund was filed on November 27, 1951 (R. 35), and more than six months elapsed without any decision on the refund claim by the Commissioner of Internal Revenue. Within the time provided in Section 3772 of the Internal Revenue Code of 1939 and on June 2, 1952, the executor brought an action in the District Court for the recovery of the taxes paid, and for such additional sum to which the estate would be entitled when the deductible amount of its attorney's fees and disbursements had been established, and for its costs of suit. (R. 3-29.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1340. The judgment was entered on July 15, 1954. (R. 48-49.) Within sixty days and on September 9, 1954, a notice of appeal was filed by the executor. (R. 50.) Within sixty days and on September 10, 1954, a notice of appeal was filed by the Collector. (R. 53.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTIONS PRESENTED.

1. Where during her life the decedent had purchased annuities payable to her and her husband jointly and, upon the death of either, to the survivor for life, and she died before her husband, whether the court below correctly decided that the value of the annuities acquired by the husband at the dece-

dent's death should be included in her gross estate within the meaning of Section 811 (c)(1)(B) of the Internal Revenue Code of 1939, as amended.

2. Whether, under Treasury Regulations 105, Section 81.10(i), the value of the annuities to be included in the gross estate is (a) the replacement cost of single life annuities, as the Collector contends, (b) the value of single life annuities under Table A of Treasury Regulations 105, Section 81.10(i), as the court below decided, or (c) the replacement cost of survivorship annuities, as the executor contends.

STATUTE AND REGULATIONS INVOLVED.

Internal Revenue Code of 1939:

Sec. 811. Gross Estate.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

* * * * * * *

(c) [As amended by Sec. 7(a), Act of October 25, 1949, c. 720, 63 Stat. 891] *Transfers in Contemplation of, or Taking Effect at, Death.*—

(1) *General rule.*—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise—

(A) in contemplation of his death. Any transfer of a material part of his property in the nature of a final disposition or distribution thereof, made by the decedent within two years prior to his death without such consideration, shall, unless shown to the contrary, be deemed to have been made in contemplation of death within the meaning of this subchapter; or

(B) under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (i) the possession or enjoyment of, or the right to the income from, the property, or (ii) the right, either alone or in conjunction with any person, to designate the person who shall possess or enjoy the property or the income therefrom; or

(C) intended to take effect in possession or enjoyment at or after his death.

* * * * * * *

(26 U.S.C. 1952 ed., Sec. 811.)

Treasury Regulations 105, Relating to the Estate Tax under the Internal Revenue Code of 1939:

Sec. 81.10. *Valuation of property.*—* * *

* * * * * * *

(i) *Annuities, life, remainder, and reversionary interests.*—* * *

(2) The value of an annuity contract issued by a company regularly engaged in the selling of contracts of that character is established through the sale by that company of comparable contracts.

* * * * * * *

STATEMENT.

The facts as found by the District Court (R. 38) are as follows:

Mrs. Grant, hereinafter called the decedent, purchased fourteen annuities in 1938 and 1939 aggregating in cost $390,000. The insurance companies agreed to pay to the decedent and her husband jointly, during the decedent's lifetime, $20,744.52[1] annually. After the decedent's death, her husband, if he survived, was to receive the same amount per year for the remainder of his life. These contracts were "single premium non-participating and non-refundable joint and survivorship annuity contracts." At the time of the purchase the decedent was about fifty-eight years of age and her husband was about fifty-nine. (R. 38.)

The decedent died on March 2, 1947, at the age of sixty-seven, survived by her husband. An estate tax return was filed which included the above-mentioned annuities in the gross estate at a value of $160,399.45. This was based on a table of mortality as provided in the Treasury Regulations when there are no comparable contracts for purposes of valuation. The commissioner took the position that there were comparable contracts and re-valued the annuities at $257,-117.20, resulting in a deficiency in estate tax in the amount of $29,235.79. This, together with interest in the amount of $161.89, was paid by the executor

[1]At other places in the record the figure $20,774.52 is used. (R. 5, 14, 45.) Perhaps the last-named figure is more accurate.

on September 22, 1950. An action for refund was filed on June 2, 1952. (R. 3-29, 38.)

The court below decided that the annuities are includable in the decedent's gross estate under Section 811(c) of the Internal Revenue Code of 1939, and that the correct valuation is $160,399.45. (R. 39-48.) Both the executor and the Collector filed appeals to this Court. (R. 50, 53.)

STATEMENT OF POINTS TO BE URGED BY THE COLLECTOR.

The court below erred:

1. In failing to hold that the annuity contracts which were transferred upon the death of the decedent from the decedent and her husband jointly to her husband alone were comparable to single life annuities within the meaning of Section 81.10(i)(2) of Treasury Regulations 105.

2. In holding that Section 81.10(i)(2) of Treasury Regulations 105 was not applicable to the present case because the annuities were not comparable to single life contracts, and at the same time valuing the contracts under Table A of Section 81.10(i)(3) of Treasury Regulations 105 as though the contracts were single life annuities.

3. In holding that the value of the annuity contracts was $160,399.45, as reported in the estate tax return, and not $257,117.20, as determined by the Commissioner of Internal Revenue.

SUMMARY OF ARGUMENT.

1. Under Section 811(c)(1)(B) of the Internal Revenue Code of 1939, the value of the gross estate of a decedent shall include the value at the time of his death of all property to the extent of any interest therein of which he has at any time made a transfer by trust or otherwise under which he has retained for his life the enjoyment of the property. Here the decedent purchased during her life annuity contracts under which a certain sum was to be paid to her and her husband jointly during their lives, and to the survivor upon the death of either one. Upon the death of the decedent, the husband alone acquired the right to the annuities for the rest of his life. In a case similar to this in all material respects this Court held that the value of the annuities should be included in the decedent's gross estate. The Court below correctly decided that the above-mentioned decision was controlling here. Furthermore, there are decisions of two other circuits to the same effect.

The executor argues in his brief that under the so-called Technical Changes Act of 1949 the annuity contracts are excludable from the decedent's estate; however, he concedes that the argument rests upon the premise that the decedent did not retain a life interest in the annuity contracts. The court below held that this Court had conclusively decided in the above-mentioned case similar to the present that the purchaser of a joint and survivor annuity retains a life interest. Therefore, by the executor's admission, the Technical Changes Act of 1949 does not require

that the annuity contracts be excluded from the estate.

2. Upon the death of the decedent, it is undisputed that her husband became entitled to annuities aggregating $20,744.52 per annum for the rest of his life. The Treasury regulation provides that the value of an annuity contract issued by a company regularly engaged in the selling of contracts of that character is established through the sale by that company of comparable contracts. The validity of the Treasury regulation has been upheld in several decisions. In accordance with this regulation, each of the insurance companies which wrote the original contracts was asked to furnish the cost of a single life annuity for a man of the age of the decedent's husband on March 2, 1947, the date of the decedent's death. The aggregate cost of the annuities was about $257,000, which was the value placed upon the annuity contracts for estate tax purposes by the Commissioner of Internal evenue. While the court below did not question the validity of the Treasury regulation, it clearly erred in holding that a single life annuity for the husband was not a comparable contract. Furthermore, after holding that single life annuity contracts were not comparable to what was transferred to the husband upon the decedent's death, the court below determined the value of the contracts to be $160,399.45, which is based upon the premise that the annuities were single life contracts and applies a mortality table instead of an annuity table, uses a higher rate of interest than that used by companies

engaged in the business, and has no loading factor or age set-back.

ARGUMENT.

I.

THE VALUE OF THE ANNUITY CONTRACTS ACQUIRED BY THE DECEDENT'S HUSBAND AT HER DEATH SHOULD BE INCLUDED IN HER GROSS ESTATE UNDER SECTION 811(c)(1)(B) OF THE INTERNAL REVENUE CODE OF 1939, AS AMENDED.

Section 811(c)(1)(B) of the Internal Revenue Code of 1939, *supra,* provides in part that the value of the gross estate of a decedent shall be determined by including the value at the time of his death of all property to the extent of any interest therein of which the decedent has at any time made a transfer by trust or otherwise under which he has retained for his life the enjoyment of the property. In this case the decedent during her life purchased a number of annuity contracts from insurance companies for $390,000, under which annuities aggregating $20,744.52 were to be paid each year to the decedent and her husband during their joint lives and to the survivor of them for his or her life. (R. 5, 38, 64-99.) The decedent died on March 2, 1947, and the annuity contracts were included in her estate tax return at the aggregate value of $160,399.45, as of the date of death. (R. 34-35, 38, 100-104.) However, in the amended claim for refund filed by the estate, the executor took the position that the annuity contracts are not includable in the gross estate. (R. 9, 11, 16-17.) The court below correctly decided that the

annuities were includable in the decedent's gross estate upon the authority of the decision of this Court in *Commissioner v. Clise,* 122 F. 2d 998, certiorari denied, 315 U.S. 821, because that case is similar in all material respects to the present.

The *Clise* case involved estate taxes of a woman who during her life purchased sixteen single-premium, joint and survivor, non-participating annuity contracts, in varying amounts, each payable to the decedent during her lifetime as the first annuitant, and to a designated second annuitant upon the death of the first annuitant. The named successor annuitant in each instance actually survived the decedent. The decedent's personal representative having failed to include the value of the annuities in the gross estate, the Commissioner determined a deficiency on the ground that the decedent had retained a life interest in the property under Section 302(c) of the Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 803(a) of the Revenue Act of 1932, c. 209, 47 Stat. 169. After the Board of Tax Appeals held that the last-mentioned statute did not in terms apply *(Clise v. Commissioner,* 41 B.T.A. 820), this Court reversed the decision of the Board and held that the value of the annuities should be included in the gross estate under the statute in question. This Court said (122 F. 2d 998, 1003-1004):

> Unquestionably, Mrs. Clise, the first annuitant, reserved to herself the enjoyment—the economic benefit, of these contracts during her lifetime. This is true, just as surely as though she had

created a trust fund with her property-money, and reserved to herself a certain sum annually, to be paid out of income and corpus, with the remainder over. Mrs. Clise reserved to herself the complete enjoyment of her property, during her lifetime, to the extent she desired to enjoy it, relieved of the worry and cares of management, and guaranteed an estate to the objects of her bounty after her death. It is clear, therefore, that Mrs. Clise retained to herself the economic benefits of her property during her lifetime.

* * * * * * *

Again, the annuities must have been based upon the life expectancy of the second annuitants, who were younger than the first annuitant. Reasoning from this, it follows that the decedent had reserved a life estate in the proceeds of the contracts, which would leave the value of the respective contracts taxable to her estate under Section 302(c): "* * * of which [decedent] has at any time made a transfer, * * * under which he has retained for his life * * * the * * * enjoyment of * * * the property, * * *."* * *

* * * * * * *

The practical effect of the annuity contracts was to reserve to Mrs. Clise the enjoyment of the property transferred and to postpone the fruition of the economic benefits thereof to the second annuitants until her death. In the light of the *Hallock* case the transfers were "too much akin to testamentary dispositions not to be subjected to the same excise." As we read the statute and understand the law of the *Klein* and *Hallock* cases, the Commissioner's position here is well taken.

The court below cited two more Court of Appeals decisions in support of its conclusion, *Mearkle's Estate v. Commissioner,* 129 F. 2d 386 (C.A.3d), and *Commissioner v. Wilder's Estate,* 118 F. 2d 281 (C.A. 5th), certiorari denied, 314 U. S. 634. Both of these cases involve facts similar to those in the present case.

In the *Mearkle's Estate* case the Third Circuit said (pp. 387-388):

> However, the question was so thoroughly discussed in the opinion of the Court in the *Clise* decision that it would smack of pedantry to repeat, so soon thereafter, an analysis of the problems dealt with in that opinion. We agree with that Court that the practical effect of such annuity contracts is to reserve to the annuitant the enjoyment of the property transferred and to postpone the fruition of the economic benefits to the second annuitant until after the death of the first, and that such transfers are " 'too much akin to testamentary dispositions not to be subjected to the same excise.' "

The executor argues in his brief that the annuity contracts are excludable from the decedent's gross estate under Section 7 of the Act of October 25, 1949, c. 720, 63 Stat. 891.[2] (Br. 7-25.) The brief states that Section 811 (c) of the Internal Revenue Code of 1939, as it read when the decedent died in 1947, required the inclusion in gross estate of joint and survivorship annuity contracts when the purchaser was survived by the other annuitant. (Br. 7.) While the brief does not state under what particular provision of the stat-

[2]Referred to by the executor as the Technical Changes Act of 1949. (Br. 7, 9.)

ute the inclusion is required,[3] under the decision of this Court in *Commissioner v. Clise, supra,* they might have come under both the retained life estate provision (corresponding to Section 811 (c)(1)(B)) and the postponed enjoyment provision (corresponding to Section 811(c)(1)(C), *supra).* The brief of the executor practically concedes that if the decedent had retained a life interest in the contracts, they would be includible in her estate. The brief reads in part as follows (p. 9):

> Admittedly, retained life interest transfers do not come within the exclusionary provision of paragraph (2) of sub-section (c) of Section 811 as added by the Technical Changes Act of 1949. If a particular transfer were a postponed enjoyment transfer which otherwise would qualify for exclusion from gross estate, it would be includable if it were also a retained life interest transfer. * * *

As pointed out above, this Court decided in *Commissioner v. Clise, supra,* that where the decedent purchased during her life a joint and survivor annuity and her husband survived her, *she had retained a life interest in the contracts.* In order to dodge the analysis of joint and survivor annuity contracts made by this Court in *Commissioner v. Clise, supra,* the executor treats the husband's contingent survivorship interest in the contracts as a separate transfer and argues that the decedent did not retain any life interest in the property transferred to her husband or the income therefrom. (Br. 13-25.) There is no evi-

[3]It may be noted that in the estate tax return the annuities were treated as jointly owned property. (R. 101-104.)

dence in the record to show that the various insurance companies would have written two separate contracts (one for the life of the decedent and one for the survivorship of her husband) at the time the decedent purchased the joint and survivor annuities, or that they would have done so without a medical examination of the decedent, or that she would have been able to pass such an examination. In this connection, it may be noted that all of the insurance companies which wrote the contracts made it clear that they would not have issued survivor annuities on the date of decedent's death. (R. 126, 128, 130, 132, 134, 136, 138, 141.) The joint and survivor contracts must be considered as one transfer, and cannot be broken down into separate parts in the absence of any evidence that the insurance companies would have written two separate contracts (one for the life of the decedent and one for the survivorship of her husband) at the same premiums charged for the joint and survivor contracts. Compare *Helvering v. Le Gierse,* 312 U. S. 531.

The executor argues that insofar as the decision of this Court in *Commissioner v. Clise, supra,* holds that the decedent retained a life interest in the annuity contracts, "it is in direct conflict with a *multitude* of other tax cases holding that the purchaser does not retain a life interest." (Br. 14.) Later on in the brief (p. 23), the executor qualifies this statement by saying that "Most, if not all, of these cases" are on all fours with the present case. We submit that none of them is on all fours with this case. *Hirsh v. United States,* 35 F. 2d 982 (C.Cls.) (Br. 16), involved a transfer

prior to 1931, and therefore prior to the time that the applicable Revenue Act contained a provision corresponding to Section 811 (c)(1)(B) of the Internal Revenue Code of 1939.[4] The Supreme Court held in analogous cases that in the absence of such a provision the property which was the subject of the transfer was not includable in the gross estate. *May v. Heiner,* 281 U. S. 238; *Burnett v. Northern Trust Co.,* 283 U. S. 782; *Morsman v. Burnet,* 283 U. S. 783; *McCormick v. Burnet,* 283 U. S. 784.

In *Commissioner v. Twogood's Estate,* 194 F. 2d 627 (C.A.2d) (Br. 17-18), it appeared that the employer paid most of the cost of the annuity and that the decedent during his life agreed to a reduced annuity in order to get a survivorship annuity for his wife; the court held that in such a case there was no reservation of a life estate. Here the decedent paid the entire cost of the annuity and was entitled to receive an annuity for her life. The case of *Estate of Bergan v. Commissioner,* 1 T. C. 543 (Br. 18-19), is materially different because it does not involve a survivorship annuity. Since in the case of a single life annuitant nothing in the annuitant's estate passes to another, there can be no estate tax and the question of retention of life interest is inmaterial. Some of the cases cited by the executor turn on the question whether the insurance company which entered into the annuity contract was a trustee; inasmuch as it is not essential under Section 811(c)(1)(B) of the

[4]The same thing is true of *Pruyn's Estate v. Commissioner,* 184 F. 2d 971 (C.A. 2d), and *Morristown Trust Co. v. Manning,* 200 F. 2d 194 (C.A. 3d), certiorari denied, 345 U. S. 939. (Br. 9, 15.)

1939 Code that the transfer be in trust because of the words "or otherwise" which follow immediately after "by trust", and we are not here urging that the transfers to the insurance company were in trust, those cases too are not applicable.

We submit that the decision of this Court in *Commissioner v. Clise, supra,* that there is a retention of a life interest where a decedent purchased joint and survivor annuities and the annuities passed to the survivor is correct, that decisions of the Third and Fifth Circuits support the decision of this Court, and that there is no decision directly in conflict with the decision of this Court. The executor having conceded that Section 7 of the Act of October 25, 1949, is not applicable to retained life-interest transfers (Br. 9), the court below correctly decided that the annuities were includible in the gross estate.

II.

UNDER THE APPLICABLE TREASURY REGULATIONS THE VALUE TO BE PLACED UPON THE ANNUITIES FOR ESTATE TAX PURPOSES IS REPLACEMENT COST OF SINGLE LIFE ANNUITIES.

Under the terms of the various annuity contracts which the decedent purchased during her life, it is clear that her husband became entitled at her death to receive for the rest of his life annuities aggregating $20,744.52 annually. (R. 38, 64-99.) The Treasury regulation relating to valuation of property in the gross

estate which applies in these circumstances is Section 81.10(i)(2) of Treasury Regulations 105, *supra,* providing as follows:

> The value of an annuity contract issued by a company regularly engaged in the selling of contracts of that character is established through the sale by that company of comparable contracts.

In accordance with the above-mentioned regulation, the Commissioner obtained from each of the insurance companies the cost of a single life annuity for the decedent's husband in the same amount as in the contract purchased by the decedent during her life, as of March 2, 1947, the date of her death. The responses of the various companies relating to the cost of such contracts may be summarized as follows:

Aetna	$ 8,045.16	(R. 106)
Aetna	24,137.47	(R. 106–108)
Connecticut General	33,583.11	(R. 109)
Sun Life Assurance	32,070.82	(R. 111)
Sun Life Assurance	32,894.75	(R. 113)
Pacific Mutual	17,746.00	(R. 115)
Pacific Mutual	9,562.00	(R. 116)
Metropolitan Life	4,393.81	(R. 117)
Metropolitan Life	13,181.42	(R. 119)
Connecticut Mutual	16,780.74	(R. 120)
Prudential Insurance	16,110.85	(R. 122)
Prudential Insurance	16,156.97	(R. 122)
Traveler's Insurance	16,226.90	(R. 124)
Traveler's Insurance	16,226.90	(R. 124)
Total Cost	$257,116.90[5]	

[5]Since there is a discrepancy of only 30 cents between this figure and the total cost appearing in the record, namely, $257,117.20 (R. 6, 13, 15, 35, 38, 39, 43, 45 etc.), we will use the latter figure because it was used by the court below.

The executor, in his brief and in the court below has not questioned the accuracy of the above-mentioned figures. Since at the decedent's death her husband alone became entitled to the annuities for the balance of his life, the annuities were comparable at that time to single life annuities, and, under the above-mentioned Treasury regulation, their value is $257,117.20.

Mearkle's Estate v. Commissioner, 129 F. 2d 386 (C.A. 3d), involves facts similar to those in the present case. There the decedent during his life purchased annuity contracts payable to his wife and himself during their lives and, on the death of either, to the survivor. The husband died first and none of these contracts were included in his estate tax return. The Commissioner determined a deficiency on the ground that they were includable in the gross estate, and fixed the value at replacement cost for a single life annuity to the wife as of the date of the husband's death, in accordance with Article 10(i)(2) of Treasury Regulations 80 (1937 ed.), which corresponds to Section 81.10(i)(2) of Treasury Regulations 105, applicable to the present case. The Board of Tax Appeals upheld the Commissioner (*Estate of Mearkle v. Commissioner,* 45 B.T.A. 894), and the Third Circuit affirmed the decision of the Board. In its opinion, the Third Circuit said (pp. 388-389):

> The valuation placed by the Commissioner, following the apposite Regulation, is the amount it would have cost to buy for the decedent's widow, on the day of his death, a similar annuity. It is now settled by final authority that for gift tax purposes, the value of a paid up life insurance

policy is the current cost of such policy at the time of the gift. *Guggenheim v. Rasquin,* 1941, 312 U. S. 254 * * *; *United States v. Ryerson,* 1941, 312 U. S. 260 * * *; followed by this Court in *Houston v. Commissioner of Internal Revenue,* 3 Cir., 1941, 124 F. 2d 518. * * *

* * *. There is no evidence in the record to show that the method of valuation adopted in the Regulations produces arbitrary results. It may well be that there are several methods of valuation which could be resorted to here, and that more than one of those methods would be reasonable. One is set out in the Regulations. They were compiled in accordance with the statute, and the general power to promulgate them, under statutory authority, is too well established to be seriously questioned. Quite obviously a Regulation prescribing a method for valuation is not to be stricken down by the taxpayer's preference for a different method. Valuation of life insurance policies when their transfer is subject to gift tax based upon cost at the time of the taxable event has been upheld in the cases already cited. While undoubtedly there are differences presented in the situation where the taxable event is the death of the first of two annuitants, we have not been shown facts which make the same method of valuation so arbitrary as to be contrary to law.

To the same effect, *United States Trust Co. of N. Y. v. Higgins,* 56 F. Supp. 997 (S.D.N.Y.). The Tax Court approved the ruling in *Mearkle's Estate v. Commissioner, supra,* in *Estate of Welliver v. Commissioner,* 8 T.C. 165, 172, and in *Estate of Walker v. Commissioner,* 8 T.C. 1107, 1111. The court below

remarked that the Tax Court came to different results in two later cases, namely, *Estate of Higgs v. Commissioner,* 12 T. C. 280, reversed, 184 F. 2d 427 (C.A. 3d), and *Estate of Twogood v. Commissioner,* 15 T. C. 989, 996, affirmed, 194 F. 2d 627 (C.A. 2d). (R. 44.) The two cases just mentioned involved annuities bought entirely, or at least principally, by employers; in both cases the employee elected to take a smaller annuity in order to obtain a survivorship annuity for his wife. In neither case did the Tax Court undertake to overrule its prior ruling in *Estate of Mearkle v. Commissioner, supra; Estate of Welliver v. Commissioner, supra,* or *Estate of Walker v. Commissioner, supra.*

The Court below did not hold that the Regulation was invalid (R. 47), but apparently held that there were no comparable contracts within the meaning of the Regulation. The opinion reads in part as follows:

> But the regulation says value is to be established by "comparable contracts." If this means comparable in type, certainly the single life contract is not comparable to the survivorship contract. If it means comparable in value, neither the single life nor the survivorship contracts are comparable to what Mr. Grant now has. When there is no comparable contract, other methods of valuation must be resorted to.

That the Court was in error in holding that the annuity contracts which were transferred to the decedent's husband upon her death were not comparable at that time to single life annuity contracts is shown

by the actuarial certificate attached to the estate tax return which purports to value *single life annuity contracts* at $160,399.45 (R. 103-104) and is the basis of the value found by the Court (R. 47). It reads in part as follows (R. 104):

> I certify that the above figures are the present values as of March 2, 1947, of an annual payment of $1.00 for the lifetime of a person aged 67, the first payment being made on the date indicated, based on interest at 4% per annum and the Combined Experience Table of Mortality. I also certify that, according to the Combined Experience Table of Mortality, the Expectation of Life for a person aged 67 is 9.96 years.

The actuary's use of single life annuities as a comparable contract would seem to be correct, because that describes exactly the type of contract which was transferred to the decedent's husband upon the date of her death. At that moment he alone became entitled to annuities aggregating $20,744.52 for the balance of his life. Therefore, the correct measure of what was transferred to him from the decedent within the meaning of Section 81.10(i)(2) of Treasury Regulations 105 is the cost of single life annuities in the same amounts obtained from the same companies which wrote the original contracts. This, as stated, is the method followed by the Commissioner.

Not only was the court wrong in holding that single life annuities were not comparable contracts, but the court found a value for the annuities which was clearly based upon single life annuities. (R. 103-104.)

Thus, in one breath the court below held that the annuity contracts which were transferred to the decedent's husband at her death were not comparable to single life annuities, and in the next breath it sanctioned a valuation based upon single life annuities under a different mortality table from that used by companies regularly engaged in selling annuity contracts, based upon a different rate of interest, and without considering any loading charge.

In connection with the Table A valuation of the annuities in the amount of $160,399.45 which was based upon single life annuities it is interesting to note that the value of payments of $1 as of March 2, 1947 (R. 104) varies in five instances from the figure opposite age 67 in column 2 of Table A. The last-named figure is $7.21699, and it will be noticed that the actuarial computation uses that figure when the date of the first payment is March 2, 1948 (R. 104), which is exactly one year after the decedent's death. The other dates of first payments vary from March 28, 1947, to December 31, 1947, and the reason that the values are higher in those instances is that where the first payment of an annuity for the life of an individual is to be paid at once, the value is increased by the first payment (or $1 is added to the figure in column 2 of Table A). (See paragraph 7 of Section 81.10(i) of Treasury Regulations 105.) Thus, where the first payment was due March 28, 1947, the value as of March 2, 1947, was given as $8.14979, which is almost one dollar more than where the date of the first payment was March 2, 1948. (R. 104.)

Having thus shown that the Court below in fact based its valuation of the annuity contracts in question on single life contracts, it necessarily follows that the annuities in question were comparable to single life annuities. Therefore, the Court should have used replacement cost as the measure of value in accordance with the directions of paragraph 2 of Section 81.10(i) of Treasury Regulations 105. *Mearkle's Estate v. Commissioner,* 129 F. 2d 386 (C.A. 3d). Paragraph 2 deals expressly with annuity contracts, whereas paragraph 3 deals with "All other future payments". The impropriety of using paragraph 3 to value annuity contracts is illustrated by the fact that insurance companies do not employ the same table for writing life insurance policies that they use for annuity contracts; in practically every instance in which the insurance companies quoted prices on annuities they used annuity tables. (R. 65, 67, 70, 72, 79, 82, 85, 88, 96, 99, 122, 126, 128, 130, 132, 134, 136, 138, 141.) The record does not show what was the life expectancy of a man born January 1, 1880, as of March 2, 1947, according to any of the annuity tables; it merely shows an expectancy of 9.96 years under a mortality table, the Combined Experience Table of Mortality. (R. 104.)

In reaching the value of $160,399.45 the actuaries employed an interest rate of 4%. (R. 103-104.) Plaintiff's Exhibit No. 17, on the other hand, shows that the insurance companies regularly engaged in selling annuity contracts used a rate between 2% and 3½%. (R. 126, 128, 130, 132, 134, 136, 138, 141.) Moreover,

the computation approved by the Court below shows no allowance for a loading charge, whereas the insurance companies which quoted a premium on surviving annuities took into consideration a loading charge of 6% to 10.885%. (R. 126, 128, 130, 132, 134, 136, 138, 141.) Furthermore, the Table A computation of $160,399.45 did not consider any set-back in age (R. 103-104), whereas some of the insurance companies used a set-back of from one to three years. (R. 126, 130, 136, 138, 141.) Thus, it would seem that the Table A method of valuing the single life annuities for the decedent's husband as of the date of her death (the method used by the executor in filing a return for the estate and the method used by the Court below) differs substantially from the method used by companies regularly engaged in selling annuity contracts: (1) it uses a *mortality* table instead of an annuity table, and it is generally accepted that the latter shows a substantially longer life expectancy; (2) it uses a rate of interest much higher than that used by companies regularly engaged in selling such contracts, which results in a lower cost of the contract; (3) it fails to take into consideration any set-back in the age of the annuitant, whereas most of the commercial companies employ such a factor; and (4) it fails to take into consideration a loading charge, which is a substantial item in computing the premium fixed by commercial companies.

One of the reasons given by the court below for not considering the annuities transferred to the de-

cedent's husband at her death comparable to single life annuities, is that the income tax law in effect at the time of the decedent's death (presumably Section 22(b)(2) of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed., Sec. 22) required the husband to report as income 3% of $390,000 (the original cost of the annuities to the decedent (R. 38)) as income each year.[6] If the Commissioner's valuation of the annuities were controlling, the court reasoned, the husband would have to pay 3% of only $257,117.20, which would be about $4,000 less than he actually included in his gross income. (R. 45.) The court infers that since the husband is not given the benefit of the $4,000 deduction in his inome tax, the annuity contracts which were transferred to him are not comparable to those previously enjoyed by the decedent and him during her life. This reasoning is not sound because there is no necessary relationship between the income tax treatment of annuities and the estate tax. If there were such a relationship, it might be argued that the annuities in the decedent's estate should be valued at $390,000, because they are valued at that figure for income tax purposes. But the estate tax requires the value to be computed as of date of death, and not at original cost. Furthermore, later income tax provisions made changes in the taxing of annuities. Section 303(b) of the Revenue Act of 1951, c. 521, 65 Stat. 452, added a sentence to Sec-

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[6]See *MacArthur v. Commissioner*, 168 F. 2d 413 (C.A. 8th).

tion 113(a)(5) of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed., Sec. 113) to provide, in effect, that if the value of a survivorship annuity is required to be included in the gross estate, and the decedent died after December 31, 1950, the survivor's base should be equal to fair market value at death. Section 303(a) of the Revenue Act of 1951 added subdivision (C) to Section 22(b)(2) of the Internal Revenue Code of 1939 to provide, effective for years after 1950, that if the basis is determined under Section 113(a)(5), the consideration paid (to which the 3% would be applicable) should be deemed to be equal to the basis to the survivor. Since these legislative changes do not even purport to determine what value is to be included in the gross estate, the lower court was plainly wrong in thinking that the income tax consequences to the survivor have a bearing on what value is to be included in the gross estate.

Furthermore, the method of taxing income in the form of annuities was changed again in the Internal Revenue Code of 1954; Section 72 thereof permits the annuitant to recover tax-free in each year of his life an amount equal to the cost of the annuity divided by his life expectancy. Here again there was no change in the estate tax provisions to correspond to the change in the income tax law.

Another factor that influenced the court below to determine that single life annuities were not comparable to what was transferred to the decedent's husband at her death is that the husband "would have

to live about thirteen years after his wife's death to recover his principal if the government's valuation were used." (R. 46.) The court remarked that this was about 30% greater than his life expectancy at the time of the decedent's death. (R. 46.) The court undoubtedly had in mind a life expectancy of 9.96 years, which was computed under the Actuaries' or Combined Experience Table of Mortality. (R. 35, 104.) The court overlooked the fact that this table is used for life insurance purposes, not for annuity purposes. As pointed out above, the insurance companies which issued the contracts in question all used annuity tables, not life insurance tables, and it is generally accepted that the annuity tables show a greater life expectancy than the life insurance tables. This record does not show what is the life expectancy of a man of 67 years under the annuity tables; but since it does show that the cost of single life annuities computed by companies regularly engaged in selling such contracts to be substantially greater than the figure obtained by the actuaries using the Combined Experience Table of Mortality, it may be inferred that the life expectancy under the annuity tables was substantially greater.

One of the points raised by the executor in his appeal from the decision of the court below is that the annuities which passed to the decedent's husband at her death are survivorship annuities and that the aggregate cost of such annuities on the date of the decedent's death would be $60,980.72. (Br. 25-39.)

The evidence to support this valuation is Plaintiff's Exhibit No. 17 (R. 125-141), which consists of a series of letters from the various insurance companies which wrote the original contracts giving their estimates of the cost of survivorship annuities. It may be noted that in all but one instance they expressly state that due to the state of the decedent's health on March 2, 1947, they would not have issued such policies in the present case. (R. 126, 128, 130, 132, 134, 136, 141.) In the remaining instance, the company wrote that "the female would have to pass a satisfactory medical examination in order to have such a contract issued." (R. 138.) In view of the fact that the insurance companies would not have written a survivorship policy on March 2, 1947, the date of decedent's death, the court below was clearly correct in rejecting this method of valuation.

Actually it is unnecessary for this Court to pass upon this point, namely, a valuation of $60,980.72, because the executor is barred by limitations from recovering more than the amount of the deficiency paid on September 22, 1950. (R. 38-39; Br. 6-7.)

CONCLUSION.

The part of the decision below which holds that the annuity contracts should be included in the decedent's gross estate is correct; the part which holds that the value to be placed upon the annuity contracts

is $160,399.45, and not $257,117.20, is wrong and should be reversed.

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Respectfully submitted,

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